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## Weathering the Storm In Student Loans

**As Furor Mounts Over Schools' Preferred-Lender Lists,  
Families Can Often Find Better Deals Shopping on Their Own**

By JANE J. KIM

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The widening college-loan scandal is highlighting the need to look beyond schools' recommended lenders. But for students and their parents, the process might be harder than they expect.

Most students who take out loans use one of the companies on their school's so-called preferred lender list because it's the path of least resistance. However, as allegations mount that some lenders have been offering incentives to secure placement on those lists, students and their parents are concerned that schools may not be presenting choices that are necessarily in their best interests.

### DOING THE HOMEWORK

Controversy over college lists of preferred student lenders underlines the need to pick your lender carefully. Here's what to consider:

- Exhaust federal loans, such as Stafford and PLUS loans, before turning to more-expensive private loans.
- Consider nonprofit lenders, state agencies, or direct federal loans for lower rates and fees.
- Apply for private loans with a co-signer who has good credit to cut costs.

It makes the most sense to shop around for a federally guaranteed loan because new lenders, knowing the government stands behind the loans, may be more willing to cut prices to quickly build market share. What's more, nonprofit groups and some state-run programs may offer better deals on these loans, and new online tools are emerging that can help borrowers compare loan offerings.

With private loans, however, students are likely to find better rates on loans offered through their schools than shopping with lenders directly, though some nonprofit groups offer even better deals. Private loans, which carry higher interest rates than federal loans, made up about 20% of the \$85 billion in new student loans last year and are increasingly being used by students as a way to help bridge the gap between the rising cost of education and the limited amount the government allows students to borrow in its programs.

When schools send financial-aid packages, they often contain loan documents with a lender's name already filled in, and many students aren't aware they have the right to choose any lender they wish. Students who do go with a lender that isn't on a school's list may encounter loan-processing delays, extra paperwork and red tape from their financial-aid office.

Norm Reddick of Westlake Village, Calif., ran into delays when he took out a loan for his daughter from a lender that wasn't on Whittier College's preferred list. Last July, Mr. Reddick applied for the loan with MyRichUncle, a student lender owned by **MRU Holdings Inc.** But he says the university didn't process the loan until October.

"When I called the financial-aid department to find out why the loan was delayed, they just said this isn't

was offering a lower rate on PLUS loans than lenders his daughter's school was recommending.

Vernon Bridges, director of financial aid for Whittier College, says any delays are usually caused when the school is unfamiliar with a particular lender. Schools typically need information such as how funds will be disbursed before they can certify a loan. He says Whittier College plans to be more proactive, including contacting students before summer vacation to find out what lender they plan to use the following term.

Schools generally defend their lists of preferred lenders, saying they have already done the homework to find the best deals for students and have considered other factors, such as the quality of customer service, in their decisions. Still, preferred lender lists are "a starting place," says Dallas Martin, president of the National Association of Student Financial Aid Administrators. "But you also have the right to go someplace else if you find something better. Some schools weren't making it as clear as they should have," he says.

As schools mail out financial-aid packages to prospective students, among the loans that may be offered to them are federally guaranteed loans. These come in two main flavors: Stafford and Perkins loans, which go directly to the students, and PLUS loans, which are taken out by the parents of undergraduates or by graduate students themselves. Aid packages may also suggest loans from private lenders.

## **Federal Loans**

Borrowers should exhaust federal education loans, which have low, fixed interest rates and more favorable repayment terms, before turning to private loans. The government has set the maximum interest rates on federal loans to 6.8% for Stafford loans and 8.5% for PLUS loans, and this is what most lenders charge. But there are breaks.

MyRichUncle is offering loans carrying rates that are one to nearly two percentage points lower than the maximum fixed rates on Stafford and PLUS loans, though the firm charges a 2% and 3% origination fee for Stafford and PLUS loans, respectively. **National City Corp.** is offering a 6.8% rate on its Graduate PLUS loan, but charges a 3% origination fee.

Many lenders, such as **J.P. Morgan Chase & Co.**, **Wachovia Corp.**, **Bank of America Corp.** and **Wells Fargo & Co.**, promise to reduce the interest rate on or the principal amount of a loan after the borrower makes a certain number of payments on time. But in reality, only a fraction of borrowers qualify for the discounts, and borrowers instead should focus on immediate discounts, financial-aid experts say.

## The Lowdown on Student Loans

Amid heightened concerns over student lending practices, borrowers should pick their lender carefully. Students who run into any problems with choosing a lender that is not on their school's preferred list should contact the Department of Education's ombudsman at [fsoombudsmanoffice@ed.gov](mailto:fsoombudsmanoffice@ed.gov) or call 877-557-2575.

### What You're Getting: Federal Student Loans

**What They Are:** Federally guaranteed, low-interest loans such as Stafford, Perkins and PLUS loans. Borrowers should try to exhaust federal education loans before turning to private loans.

#### What to Look For:

- Although the government sets the maximum interest rates on federal loans at 6.8% for Stafford loans and 8.5% for PLUS loans, some lenders will discount that rate.
- Look for lenders that offer immediate rate discounts or other benefits that you can't lose, such as a waiver of loan fees or a reduction in the principal amount of the loan. [FinAid.org](http://FinAid.org) offers calculators that can help borrowers assess the value of those benefits.
- Many nonprofit lenders, including state-run programs, also offer good deals. For a list, visit the Education Finance Council's Web site at [www.efc.org](http://www.efc.org) and click on the link "Read More About Borrower Benefits."

### What You're Getting: Private Student Loans

**What They Are:** Also known as alternative loans, private loans are offered by private lenders, with terms set by the lender, not the government. The loans, which are based on a borrower's credit history, can be used to fill the gap when federal loans don't provide enough money or when borrowers need more-flexible repayment options.

#### What to Look For:

- Private loans are more expensive than federal loans, with annual percentage rates that can range from 8% to 20%, including fees. Applying for a private loan with a creditworthy cosigner can help lower your rate. For a list of many private loans and their loan terms, visit: [www.finaid.org/loans/privatestudentloans.phtml](http://www.finaid.org/loans/privatestudentloans.phtml).
- The fees charged by some private loans can significantly increase the cost. Look for a loan with a relatively low interest rate and low fees.
- Interest rates on most private loans are variable and can be a good bet if you expect rates to drop for the next couple of years and if you plan to pay off the loans when rates go up (conversely, they will be more expensive in a rising-rate environment).

Source: WSJ research

Student lender **Nelnet** Inc. says borrowers who take out new Stafford loans after July 1 will be able to get a one-percentage-point rate cut if they sign up to have their payments automatically debited from their bank accounts, up from the current 0.25% discount. **Citigroup** Inc.'s student lending unit says it will automatically drop its rate by one percentage point once students start repaying their loans, typically after graduation.

Borrowers should also check with their state to see if there are any benefits available. Michigan residents, or non-residents who attend schools in the state, can take out federal loans through the Michigan Higher Education Student Loan Authority, a nonprofit agency, and see their interest rate fall to zero after they make 36 months of on-time payments. The Missouri Higher Education Loan Authority, or Mohela, a nonprofit lender in St. Louis, reduces the rate by two percentage points for borrowers making automatic payments on PLUS and Stafford loans. The Missouri deal is open to any

student nationally.

And borrowers also can get a better rate on PLUS loans -- 7.9% -- if they skip the intermediary lender and borrow directly from the federal government. There's also an additional 0.25% discount if they sign up for automatic payments. One hitch: Only about 20% of the nation's schools participate in the Federal Loan Program for direct loans.

Graduate and professional students also now have a cheaper alternative to private loans. As of last July, graduate students could take out a PLUS loan up to the cost of education, minus any aid received.

Tony Gruia of New York estimates he saved about \$3,000 by expanding his search beyond his school's preferred lenders. The 31-year-old decided to use an advisory service, Graduate Leverage, which matched him with a lender that was willing to offer 5.8% on his Stafford loans and 7.2% on his Graduate PLUS loans. "I honestly don't care who gives me the money as long as I get the best rate," says Mr. Gruia, a first-year student at Columbia Business School.

## Private Loans

Some students may opt for private loans if they need to borrow more than the total cost of tuition, such as

to pay for computer or travel expenses, or if their parents can't or won't assume responsibility for a PLUS loan. Borrowers also often turn to private loans if they want low monthly payments in repayment since private loans have longer terms than federal loans. But these loans are generally more expensive. Interest rates, which are variable, can range from roughly 7% to 18%, depending on your credit score, while guarantee fees, usually one-time charges, can range from 0% to 11.5%, according to Mark Kantrowitz, founder of FinAid.org, a financial-aid Web site.

In recent years, new lenders, such as **Greystone** & Co.'s GCO ELF and GMAC Bank, part of GMAC Financial Services, have jumped into the student-loan market by offering private loans directly to borrowers, and big banks, including **KeyCorp's** KeyBank, are also expanding their private-loan businesses. In 2005, SLM Corp., known as Sallie Mae, launched a suite of private loans called Tuition Answer aimed directly at borrowers.

Some nonprofits also offer private loans. The Massachusetts Educational Financing Authority, for instance, offers private loans with a fixed rate of 6.39% to state residents or students who attend schools in the state.

Although borrowers now have more choices, it's more difficult to shop around for private loans. That's because borrowers must take into account both the rate and guarantee fees each lender charges. Also, borrowers must actually apply for a loan to get a quote, and multiple loan applications can hurt your credit score.

New tools are making it easier to shop around. FinAid.org is planning to introduce a calculator in the coming weeks that will let users compare college loans. Other Web sites, such as SimpleTuition.com and eStudentLoan.com, also allow users to compare options among a set of loans, although the sites have financial ties to lenders, who may advertise on the sites or pay referral fees.

To keep costs down, apply for private loans with a co-signer with a strong credit score. The Education Resources Institute, or TERI, an industry group that guarantees to repay lenders if a student defaults on a private loan, recently began allowing borrowers of loans it guarantees to release the co-signers from the loans after they make the initial 48 payments on time and meet a creditworthiness test.

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